In cooperation with

INSTITUTE
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FORECAST SERIES
UKRAINE

Economic forecast for 2024

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Executive Summary

- RUS full-scale war is ongoing and keeps having a devasting impact on Ukraine's economy
- After a GDP decline of 28.8% in 2022, Ukraine's economy started to slowly recover with GDP increase in 2023 and growth forecast for 2024
- Based on certain assumptions on the war and international aid, we estimate a **GDP growth at 5.2% in 2023 and forecast it at 4.0% in 2024**
  - Supply side: agriculture demonstrated strong growth in 2023, while transport experienced further decline. Both sectors will grow in 2024
  - Demand side: Private consumption will remain the main driver in 2023 and 2024
- Trade deficit is not expected to be offset by grants provided by international donors , **leading to a CA deficit**
- Average inflation (aop) is forecast to **reduce to 6.2% in 2024 compared to 12.9% in 2023**
- International support is not expected to fully close the fiscal gap, thus domestic borrowing is forecast to still play a significant role
- As a result, the debt burden is forecast to further grow **to 95.5% of GDP in 2024**
- However, the forecast is subject to large uncertainty related to further development of the war

Structure

1. Introduction

Background:

- Russia's full-scale war has been ongoing for 22 months
- The **displacement of millions of people**, **further fighting**, **temporary occupation of Ukraine's territories**, **mines**, **destroyed infrastructure** and **blocked logistic routes** and further war-caused challenges continue to negatively affect the economic development in 2023 and 2024
- At the same time, Ukraine has been showing strong resilience in repairing damages caused by Russia but is **relying on the ongoing international support**
- Any forecast of the future economic development is however subject to massive war-related uncertainty and possible revisions

Purposes of this analysis:

- Update the forecast for the main macroeconomic indicators for 2023 and 2024 forecasts
- Discuss main downside and upside risks for the forecast

2. Economic review of 2023

- Due to the full-scale war, the business sector has been facing substantial impediments, including **danger to work, high input prices, lack of access to electricity, and problems with logistics**
- In Jul-23, Russia finally withdrew from the Black Sea Grain initiative, having delayed ship inspections prior to that
- However, Ukraine was able to ensure security of shipping unilaterally from a number of Black Sea ports **while further ports remained blocked or occupied**
- Cross-border surface transport reduced due to restrictions on agricultural exports since May-23, and obstruction of road border crossings in Nov and Dec-23 by truck drivers from Poland and other countries
- Ukrstat quarterly real GDP flash estimates: -10.5% yoy in the 1Q2023, +19.5% yoy in the 2Q2023, +9.3% yoy in 3Q2023

→ Economic activity in most sectors improved compared to 2022 but remained much lower than in 2021

Review of inflation and current account

Inflation:

- Over 2023, inflation decelerated and reached 5.1% in Dec-23 – strong drop compared to 26.6% in DEC-22
  - Good harvest contributed, while logistics improvements reduced supply chain disruptions
  - The Government kept all utility tariffs except electricity for households fixed. Electricity price **increased by 70% in June to reduce subsidy costs**

Current account:

- Blocked export routes kept having an adverse trade impact in 2023: Sea routes by RUS, road routes by a few EU member states
- Imports recovered gradually
- International transfers and remittances were not enough to offset the increased trade deficit in 2023
- Service trade deficit reflects spending of Ukrainians abroad

→ CA surplus in 2022 turned into a deficit in 2023

Review of economic policies

NBU:

- Key policy rate equals overnight deposit rate since Oct-23
  - The NBU lowered policy rate four times in 2023 reaching 15% p.a. in Dec-23
  - Disinflationary factors have exceeded the NBU's expectations
  - Majority of the Monetary Policy Committee expect that key rate will remain in **13-15% p.a. range in 2024**
- Managed variable exchange rate reintroduced in Oct-23
  - The NBU decided to allow limited fluctuations in the exchange rate, but it largely maintained its oversize role in the FX market selling dollars to keep the USD/UAH exchange rate stable
  - In Dec-23, the exchange rate ended at UAH/USD 38.00 which is weaker than UAH/USD 36.57 set in Jul-22, **deviation to cash-market rate remained below 5% since 2023Q2**
  - FX restrictions were partial liberalised including restrictions on cash FX purchases.
  - The NBU is expected to move **according to the approved strategy** for liberalising FX restrictions that foresees a gradual increase in flexibility if underlying macroeconomic conditions remain favourable

→ NBU cut the policy rate to 15% in line with declining inflation; managed floating exchange rate policy reintroduced in Oct-23

Review of economic policies

The Parliament / the Government:

- » The government and the parliament fulfilled all commitments needed to receive financing under the IMF programme (second review) and MFA+ from the EU – **all expected financial resources were received in 2023**
- » Reform progress paved the path for the **EU to open negotiations on full membership**
- » The taxation system effective before the full-scale invasion was largely restored
- » Electricity tariffs for the population were finally increased in Jun-23, but natural gas, water and heating prices remain unchanged.
- » The approved State Budget Law for 2024 envisages **sharp decline in financing capital outlays** due to the high need to increase defense and security spending
- » Subsidised loan programme 5-7-9% remained key source of lending in 2023 reaching 40% of outstanding corporate loan portfolio
- » The government approved the **National Revenue Strategy (IMF conditionality)**

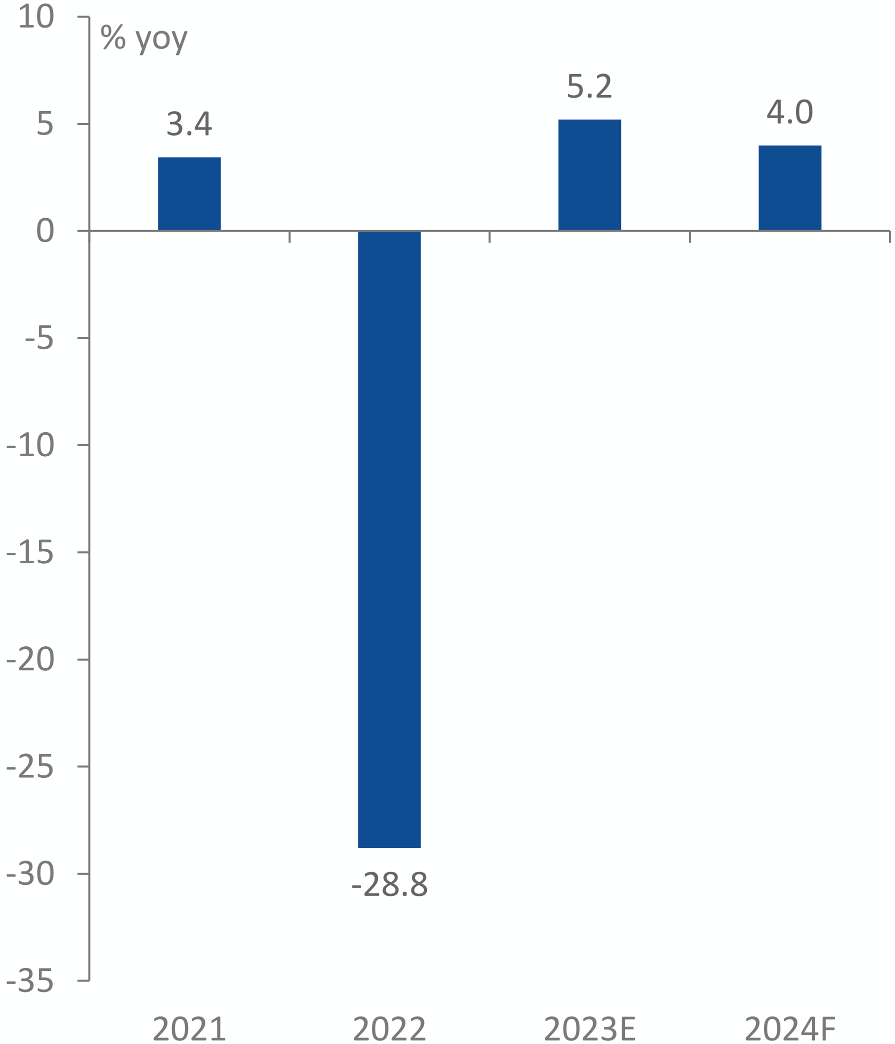
→ Overall, financial support arrived as planned during 2023 and the underlying conditionality was met

3. Assumptions underlying the forecast

- Ukraine will continue to gradually work towards de-occupying its territories
- **War intensity will not reduce in 2024**
- Recovery and reconstruction spending will be limited to high-priority investments in 2024. Recovery spending will be largely financed by IFIs loans and other donor assistance.
- Sea shipping will gradually expand in 2024
- Western border of Ukraine will operate mostly unobstructed for trade in 2024
- Danube river ports will remain in operation for exports
- Energy infrastructure will remain resilient despite possible Russian attacks during 2024
- **The United States, the EU, and other international partners will deliver on commitments to provide the financial and military support needed**
- **The current IMF programme will remain on track in 2024**
- Capital controls will be gradually relaxed in line with the recently approved strategy
- **Key policy rate will remain close to 15% p.a. in 2024**
- **No substantial changes in tax policy in 2024**
- Financial sector will remain stable
- The Government will gradually increase utility tariffs in the second half of 2024
- **More Ukrainians will return than leave**: net decrease in Ukrainians abroad

4. Key forecast indicators for 2024

Ukraine's real GDP change



Source: Ukrstat, own forecast for 2023 and 2024

Key GDP parameters:

» Real GDP increase of **5.2% yoy in 2023** and **4.0% yoy in 2024**

» Nominal GDP: UAH 6,133 bn (USD 168 bn) in 2023 and UAH 7,002 bn (USD 183 bn) in 2024

Key driving forces:

» Increased GVA in agriculture, trade, and industry but from a low base

» Domestic demand will increase gradually as liquidity and only slow return of Ukrainians home restrict acceleration

» Fixed capital accumulation will grow from very low base to cover essential repair and rebuilding efforts

» Balanced growth of external trade due to improved logistics and weaker exchange rate; but still negative contribution of net real exports

➢ **GDP in 2024 projected to remain more than 21% below 2021 level but closer on per capita basis**

➢ **Uncertainty remains high**

GDP forecast: demand side

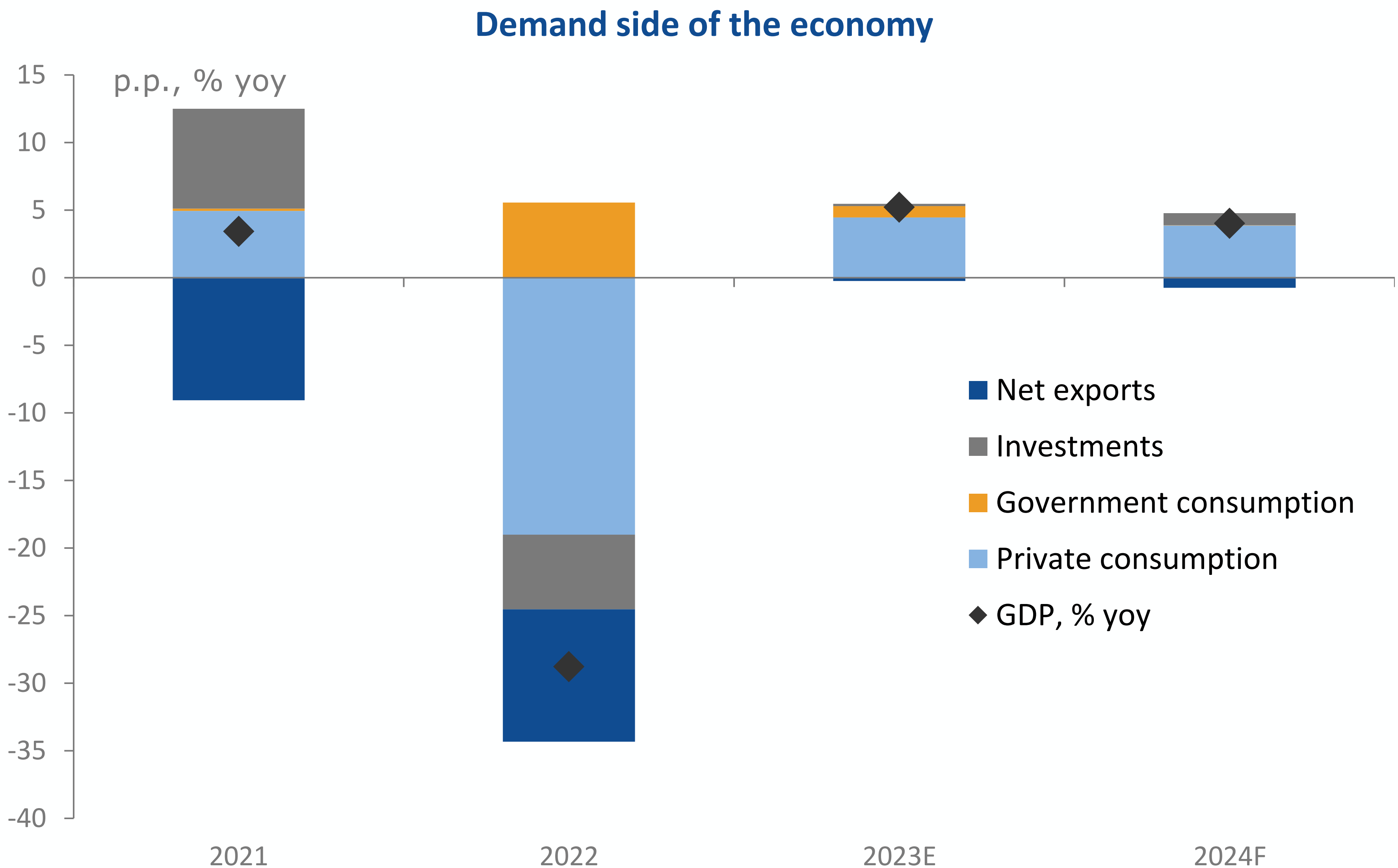
Real GDP forecast: demand side (change in %)

	2021	2022	2023E	2024F
GDP	3.4	-28.8	5.2	4.0
Including:				
Private consumption	6.8	-28.7	7.1	5.9
Government consumption	0.8	31.4	2.1	0.1
Fixed capital accumulation	9.3	-33.9	10.4	10.7
Exports	-8.6	-42.0	0.8	2.6
Imports	14.2	-17.4	1.0	3.0

Source: Ukrstat, own forecast for 2023 and 2024

- Private consumption: Growth due to improved labour market situation and use of savings
- Investments: Growth from very low base is attributed to priority reconstruction and repair needs, growth in defense investments as well as gradual rebound in private investment but . the negative contribution of lower inventories exceeds positive contribution of fixed capital accumulation
- Real exports: Only slight growth in 2023 due to occupied, damaged and newly blocked export routes. Growth will be stronger in 2024 due to improved logistics, primarily via the sea
- Real imports: Increase in 2024 in response to higher demand
- Trade deficit: Both in 2023 and 2024

Contributions to real GDP growth: demand side



Source: Ukrstat, own forecast for 2023 and 2024, Investments include gross fixed capital accumulation and inventories. The negative contribution of lower inventories exceeds the positive contribution of fixed capital accumulation

GDP forecast: supply side

Real GDP forecast: supply side (change in %)

	2021	2022	2023E	2024F
GDP	3.4	-28.8	5.2	4.0
Including:				
Agriculture	15.1	-25.2	8.9	3.4
Industry	1.4	-37.7	2.8	5.9
Trade	-0.1	-32.2	13.4	5.7
Transport	1.7	-40.5	-7.5	8.6

Source: Ukrstat, own forecast for 2023 and 2024

- Agriculture: Area under major crops increased (mostly for oil crops) and grain yields exceeded 2021 records leading to substantial increase in agricultural production in 2023 and recovery in animal products, higher areas sowed after demining lead us to expect slightly higher production in 2024
- Industry: Increase in 2023 was limited by Russian-caused infrastructure damages and exports restrictions, Improvements are expected in this regard in 2024
- Trade: Recovery in retail sales in 2023 and further growth in 2024
- Transport: Limited export trade flows and consolidation of domestic logistics leads to further strong decline in 2023 but logistics improvements and higher external and domestic trade flows are projected to help recovery in 2024

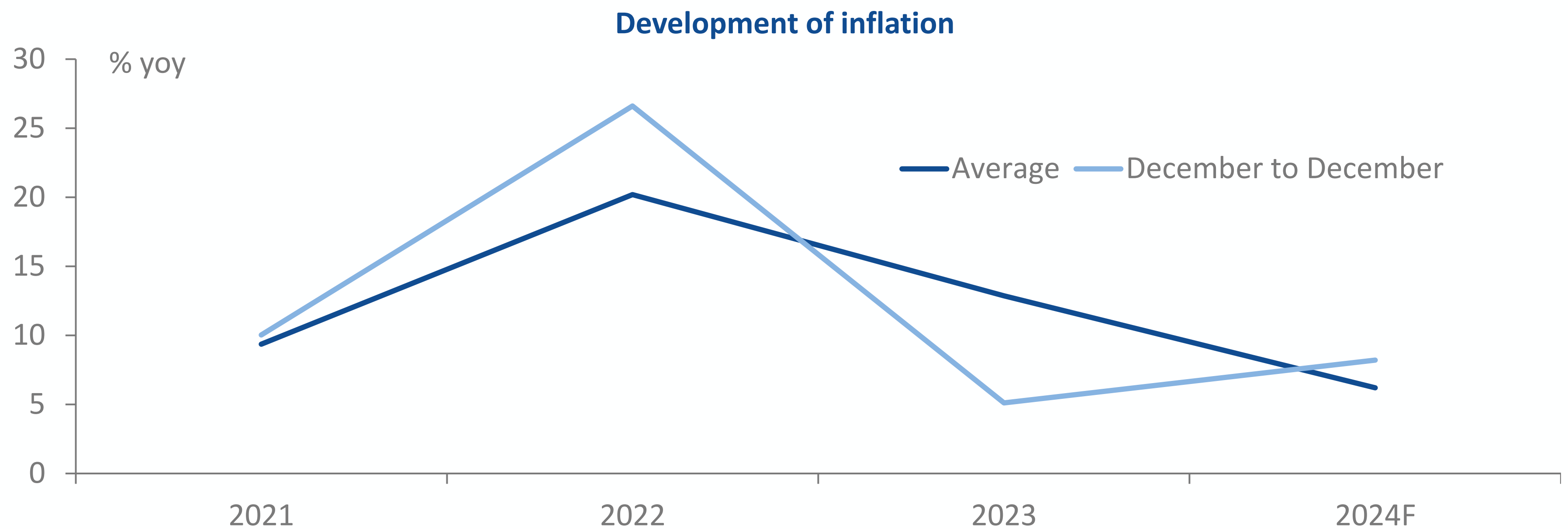
Current account forecast

Current account					
		2021	2022	2023E	2024F
Current account balance	USD bn	-3.9	7.9	-7.4	-14.9
Current account balance	% of GDP	-1.9	4.9	-4.4	-8.1
Exports of goods	USD bn	63.1	40.9	34.3	34.9
Imports of goods	USD bn	-69.8	-55.6	-61.2	-67.1
Balance of services	USD bn	4.0	-11.0	-8.5	-7.4
Transfers and remittances*	USD bn	18.2	38.0	33.2	30.4

Source: Ukrstat, own forecast for 2023 and 2024

- Lower prices and logistics constraints led to lower exports in USD terms in 2023. In 2024, we expect an easing of logistics constraints and more favorable prices.
- Gradual recovery in domestic demand is projected to increase imports in 2023 and 2024
- The services deficit reflects continued spending by refugees abroad. It decreased in 2023 and is projected to fall in 2024 in line with the return of some migrants and the transitions to non-residents
- (*)Transfers and remittances refers to sum of net wage income and secondary transfers and include grants to the state budget at USD 13 bn in 2023 and USD 11 in 2024

Inflation forecast



Source: Ukrstat, own forecast for 2024

» 2023: Ended with **12.9% aop and 5.1% eop**: inflation gradually decelerated

- Recovery from supply chain disruptions, good harvest, lower global prices for energy and some commodities and stop of monetary budget financing have reduced inflation pressure

» 2024: Projected at **6.2% aop and 8.2% eop**:

- Increases in tariffs, decompression of margins under stronger consumer demand will offset effects, falling off effects from good harvest and lower commodity prices in 2023
- Better supply chains, tight monetary policy and lower inflation expectations are expected to limit effects

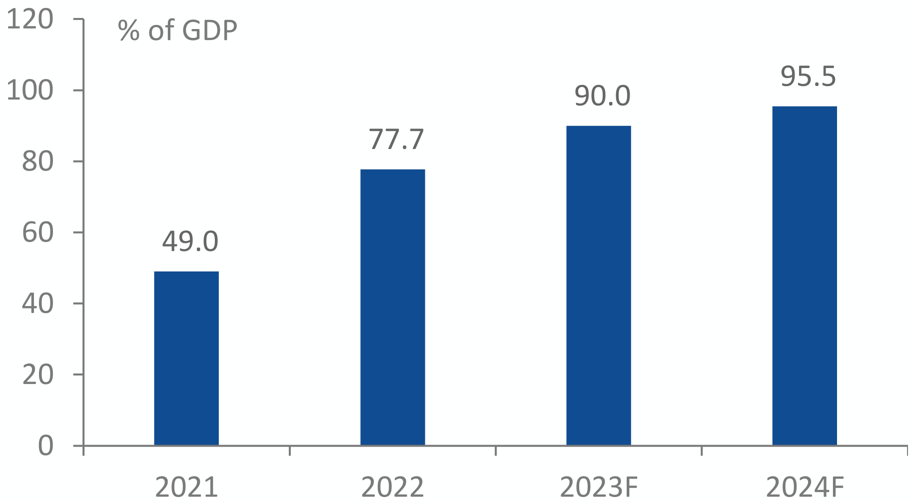
Fiscal forecast

Summary of fiscal indicators

	2023E	2024F
Consolidated fiscal deficit (grants <u>not</u> accounted as revenues), USD bn	47.6	40.3
Consolidated fiscal deficit (grants <u>not</u> accounted as revenues), % GDP	28.4	22.0
Financing needs, incl. domestic bond refinancing USD bn	55.0	50.0
Assumed international aid (grants and loans), USD bn	42.5	36.0

Source MinFin, own forecast for 2023 and 2024

State and guaranteed by state debt



Source MinFin, own forecast for 2023 and 2024

- Consolidated fiscal deficit will remain high
- Expected financing needs higher than expected international aid
- In the beginning of 2024: JAP, CAN, NOR, and some other countries are expected to finance the deficit
- The IMF, the EU, and most other bilateral assistance **will be provided as concessional loans, which will add to debt burden**
- Public debt (incl. guarantees) is expected to increase to about **95.5% of GDP in 2024**
- The Government is expected to **negotiate an external commercial debt restructuring by September 2024**.
- However, the uncertainty on financing remains high in 2024

5. Key risks of the forecast

Downside risks:

- Worsening of security situation and further occupation of territories
- Increasing infrastructure destruction all over Ukraine
- Unexpected delays in financial assistance from IFIs and bilateral donors
- Damage to grain export facilities as well as disruption of seaborne exports

Upside risks:

- De-occupation of Ukrainian territory, improved security situation
- Faster than expected recovery of seaborne exports
- Larger than expected donor inflows, i.e. for reconstruction, or from frozen assets

Annex: Technical note on modelling

- The forecast was produced using the IER short-term macroeconomic forecasting model. The model is based on iterative-analytical techniques, grounded in the system of national accounts.
- The model looks at GDP and its components based on production and expenditures. The final result of the GDP forecast is based on forecasts for each component.
- The forecast for each component is produced using scenario assumptions and historical relationships. The forecast is built on a system of built-in proportions, which are expected to stay fairly constant.
- Components of the GDP by production and by expenditures are interconnected.
- Real GDP growth is determined by the summation of the contributions of each component. If the two sides of the GDP accounting equation are not balanced, then another iteration begins. The iterations continue until the two methods of GDP produce balanced results.

Annex: Forecast indicators

		2021	2022	2023E	2024F
Real Economy					
Nominal GDP	UAH bn	5,451	5,239	6 133	7 002
Nominal GDP	USD bn	199.8	162.0	167.7	183.1
Real GDP	% yoy	3.4	-28.8	5.2	4.0
Consumer price index	aop, % yoy	9.4	20.2	12.9	6.2
Consumer price index	eop, % yoy	10.0	26.6	5.1	8.2
Balance of Payments					
Current account balance	USD bn	-3.9	7.9	-7.4	-14.9
Current account balance	% of GDP	-1.9	4.9	-4.4	-8.1
Exports of goods	USD bn	63.1	40.9	34.3	34.9
Imports of goods	USD bn	-69.8	-55.6	-61.2	-67.1
Balance of services	USD bn	4.0	-11.0	-8.5	-7.4
Exchange rate (official)	aop, UAH/USD	27.29	32.34	36.57	38.24
State and guaranteed by state debt	% of GDP	49.0	77.7	90.0	95.5

Source: Ukrstat, own forecast

About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.
**Advisory activities in Belarus are currently suspended.*

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